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October 17, 2006

AGENDA ITEM 8

TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE

- I. SUBJECT:** Proposed Regulations: Prefunding Plan for Health Care Coverage for Annuitants
- II. PROGRAM:** Health Benefits, Actuarial and Employer Services
- III. RECOMMENDATION:** Staff recommends that the Committee recommend the Board approve for publication the proposed amendments to regulations that clarify and make specific existing provisions in the Public Employees' Medical and Hospital Care Act (PEMHCA) concerning the Annuitants' Health Care Coverage Fund and the prefunding of health care coverage for annuitants.
- IV. ANALYSIS:**

Background

Health benefits provided through CalPERS health plans are currently funded through employer, employee, and retiree contributions. For most employers the contributions are not prefunded, but rather are designed to fund premium costs on an annual basis. Prefunding is a means of enhancing the security of health care benefits for retirees. This process provides money dedicated to retiree healthcare which could be more secure than depending upon pay-as-you-go funding. Pay-as-you-go funding may be subject to economic cycles so that employer payments could be reduced during economic downturns and/or the range of covered health benefits could be reduced.

Since 1992, the Financial Accounting Standards Board in FAS 106, has required employers in the private sector to measure their obligations for retiree health

liabilities, to post a measure for the unfunded post retirement health liability on their balance sheets, to post the annual expense for these benefits in the income statement, and to disclose the unfunded liability and expense in the footnotes in their financial statements. These employer disclosures are currently required by FAS 132(R) which appeared in 2003 and supercedes FAS 106. Now, the Governmental Accounting Standards Board (GASB) Statement 45 has extended the concepts of FAS 106 to the governmental entities by approving accounting and financial reporting requirements for employers for Postemployment Benefit Plans other than Pension Plans (GASB 43) and for Postemployment Benefits other than Pensions (GASB 45). The new requirements will be implemented in three phases (depending on the size of the governmental entity) with the first phase taking effect for reporting periods beginning after December 15, 2005 for plans under GASB 43 and after December 15, 2006 for employers under GASB 45.

Current Law--Annuitants' Health Care Coverage Fund

The Legislature recognized a need to establish a means for prefunding retiree health benefits and in 1988 it adopted a law (Stats. 1988, ch. 331) that created the Annuitants' Health Care Coverage Fund (AHCCF) for the purpose of prefunding health care coverage for annuitants. The law allows a PEMHCA employer to elect to participate in the prefunding plan. The law provides further that the CalPERS board has sole and exclusive control and power over the administration and investment of the AHCCF.

Board-sponsored Legislation--SB1729

The board was the sponsor of SB 1729 which was vetoed by the Governor in September 2006. The bill addressed many of the items that are contained in the proposed regulations. Therefore, if SB 1729 had become law, then the proposed regulations would not have been necessary. However, since the legislation was not enacted into law, the proposed regulations will provide the administrative framework for implementation of the current law.

Proposed Regulations (Attachment I)

The proposed regulations will clarify and make specific the current law by:

- defining terms;
- providing how an employer contracts with CalPERS;
- providing that CalPERS is to determine the amount of administrative costs and expenses to be paid by each participating employer, and
- specifying the terms and conditions that must be included in the contract (which include the disbursements from the plan, the methodology and assumptions used to calculate the actuarial accrued liability for health care coverage, the method of payments to and disbursements from the plan, the reporting requirements, the method for allocating investment income, the

circumstances for transfer of assets into or out of the plan, and the conditions under which the plan may be terminated).

In order for the regulations to be effective early 2007, staff recommends that the Board approve commencement of the regulatory process by authorizing publication of notice in the California Regulatory Notice Register by November 3, 2006. Assuming publication on November 3, 2006, after 45 days, the Committee may hold a public hearing on December 19, 2006, and, assuming there are no changes, the Board may adopt the regulations at its meeting on December 20, 2006. Thereafter, assuming prompt filing of the regulations package with the Office of Administrative Law (OAL) on December 20, 2006, and assuming that OAL approves the regulations on the 30th working day following receipt, the earliest effective date would be February 5, 2007, if the Secretary of State grants the Board's written request for an early effective date. If there are changes to be made or if the OAL disapproves the regulations, or if the Secretary of State does not grant the request for an early effective date, the effective date will be some time after February 5, 2007.

Discussion

GASB 45 requires government employers to report in their financial statements the estimated costs and liabilities associated with postemployment health benefits for current and future retirees. The AHCCF will provide a vehicle for participating employers to contribute an amount to cover some or all of their expected liabilities for health care coverage for annuitants. The AHCCF would serve the purposes of enhancing security for retirees, and providing employers a choice of investment vehicles implementing California Government Code sections 22940 *et seq.* Adoption of the proposed regulations will provide administrative details for participation in the AHCCF.

V. STRATEGIC PLAN:

This item supports Enterprise Goal I: Exercise global leadership to ensure the sustainability of CalPERS' pension and health benefit systems.

VI. RESULTS/COSTS:

The GASB project team continues to finalize the implementation plan that will allow PEMHCA employers to prefund their retiree health care unfunded liabilities through CalPERS. Minimal if any additional resources will be required in fiscal year 2006/07. For those employers who elect to fully prefund their retiree health care liabilities, thereby utilizing a higher discount rate in their actuarial valuations, the actual cost for those liabilities to the employer/taxpayer can be reduced by 50 percent or more.

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Attachment I